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## RAILROADS IN THEIR CORPORATE RELATIONS.<sup>1</sup>

### SUMMARY.

Causes of railroad amalgamation, 34.—Corporate control of railroads defined, 36.—Control through lease, 38.—Control through ownership of securities, 39.—Joint control, 41.—Virtual control, 44.—Inactive corporations, 45.—Minority holdings of railroad securities, 46.—Holding companies: trust companies, intermediate holding companies, land and improvement companies, 50.—Entanglements of the intercorporate relationship, 54.—Holding companies at the head of systems: Atlantic Coast Line Company, Reading Company, Rock Island Company, 58.—Purpose of the holding company and reasons for public opposition, 61.—Suggested remedies, 64.

For many years, concentration of railroad interests in the United States has been recognized as a "growing tendency." At the present time, so far has the movement proceeded, it may almost be regarded as an accomplished fact. An illustration may be taken from the monthly reports made to the Division of Statistics and Accounts of the Interstate Commerce Commission. Up to August 10 of this year 750 reports had been received of May revenues and expenses, covering 226,407 miles of line operated. Of this total, 197,600 miles, or 87 per cent., were comprised within forty railroad systems, including monthly reports from 322 separate railroad corporations.

The suggested causes for this amalgamation of railroad lines have been numerous and diverse. Desire for control pure and simple—the satisfaction which comes from the exercise of power—has played its part. The wish to

<sup>1</sup> The author of this article was connected during the year 1907-08 with the Division of Statistics and Accounts of the Interstate Commerce Commission, and was responsible for the compilation and for the technical portion of the text of Special Report No. 1 on Intercorporate Relationships of Railways in the United States as of June 30, 1906 (Government Printing Office, 1908). This article presents in an informal manner the results of that study, together with comments and expressions of opinion for which obviously the author is alone responsible.

provide opportunities for market manipulation and speculative gains has been an influential motive. The tendency of business in this country to be assembled in large units for the promotion of economies in administration and general efficiency has unquestionably contributed its influence to the movement. But, more than all these, the attempt to operate railroads in freedom from legislative and judicial interference, and at the same time to avoid the disastrous results of an unrestrained competition, has been charged or credited, according to one's point of view, with being the principal incentive to consolidation or concentration of railroad interests. For the railroads were compelled, with the dissolution of pools by the passage of the anti-pooling clause of the Interstate Commerce Act, and with the disbanding of the traffic associations by the judicial interpretation of the Sherman Anti-trust Act, to attain their desired end by more thorough-going methods.

The present discussion has not to do with tracing the life history of this concentration movement among railroads, nor with presenting a detailed picture of the present situation. Because of the multiplicity of detail, such a picture would be tedious and confusing, and, as a presentation of the actual situation, could not hope to be accurate for any length of time. This paper is concerned rather with such fundamental principles as seem to underlie the relationships of railroads, and will therefore resort to actual conditions merely for the purpose of illustration.<sup>1</sup>

<sup>1</sup> Poor's Manual of Railroads and Moody's Manual of Railroads and Corporation Securities give the details and the changes from year to year in the intercorporate relations of railroads. While they have no power to elicit information and rely in the main upon published reports, they are fairly accurate in their statements of facts. This paper, while drawn mainly from the Intercorporate Relationship investigation, as of June 30, 1906, brings its illustrations, unless otherwise noted, down to June 30, 1907. It is impossible to secure official information of a later date, as the annual reports of railroads for the year ending June 30, 1908, are not required to be submitted to the Interstate Commerce Commission until October 31.

Consideration will first be given to alliances which are sufficiently intimate to effect the control of one corporation by another. By control of a corporation is meant the power to dictate the policy of such corporation. This movement for control has assumed various phases. The simplest case is that in which a railroad desires to enlarge its territory and influence, where efficient railroading demands that joint arrangements with branch connecting lines be superseded by centralized management, or in which the constant pushing out of branches to gather in new sources of traffic is essential to the very life of the main stem of a railroad line. Then there is the extension of the main line into sections not before reached,—the transformation of a railroad serving a locality into a system that traverses a section and then half a continent,—illustrated in the policy of Eastern “trunk lines,” which early realized the advantages of tapping the producing sections and by unified control and management reducing to the lowest point the cost of handling the enormous traffic in raw materials. The latest phases of this movement are seen in the newly constructed and projected lines to the Pacific and in the plans of certain interests for controlling transcontinental lines that touch both oceans.

Frequently the acquisition of control of an individual railroad is a part of some such far-sighted plan which does not appear on the surface, but is still only a dream or a desired culmination in the mind of a dominating financier, and which becomes clear to the public only after all the links have been connected and the system takes visible form. One has only to read the financial page of the daily newspaper and take note of the rumors of new corporate alignments to realize how alert is the public to scent incipient plans of this nature. Only on some such theory as this can many of the relationships of widely

separated railroad corporations be explained. Rivalry between different financial groups has accelerated the movement and has forced one group to meet the gigantic projects of another or suffer loss of business and of prestige.

As we have seen, the motives underlying the movement are not wholly economic, altho this motive is the dominant one. The prestige that springs from corporate power and financial control is a precious possession, to be guarded at all hazards and enhanced at every opportunity. This competitive struggle for financial power justifies itself only so long as it keeps its feet solidly on economic ground. If the development of systems works for efficiency in transportation, in the way of better service and lower rates, it can be defended; but experience proves that, in most cases, such rivalry has led to absorption of railroads merely because of their strategic advantage in a warfare of financial interests. It is but a short step from this practise to stock jobbing, manipulation, and often railroad wrecking, and, when the interests involved have had enormous resources at their command, the influence of such practises has not been confined to railroads, but can be traced into the management of banks, insurance companies, and other financial and fiduciary institutions. Such reprehensible practises have been particularly evident in the management of railroads in which boards of directors, elected for the purpose of directing a transportation agency, have delegated their functions to one dominating personality, and have then gone about their business.

Finally, as a cause of railroad control there may be mentioned the motive of pure investment. But this is very infrequently a dominating motive. Investments by railroads in the securities of other railroads are common, but, unless some other motive is present, they rarely extend to the point of actual control.

Control over a corporation may be established in a variety of ways; but the two principal methods of effecting the result are control through possession of securities, usually stock or its equivalent, and control through some form of contract, such as a lease. It is somewhat questionable whether a lease contract gives control at all, for on its face it usually transfers merely the use of physical property of a corporation for a limited term of years and leaves the corporate organization, with its board of directors and its stockholders, untrammelled. The corporation, at least formally, continues its existence, maintains its organization, and distributes as dividends on stock the rentals received from the lessee company. Breach of contract, a receivership, or the termination of the contract, may restore the property of the lessor company to its stockholders. This is the strict legal relation of the two corporations, and from this standpoint it would seem proper to disregard such relationships in any consideration of intercorporate control. Yet a careful study of lease contracts reveals the fact that the relationship of lessor and lessee extends all the way from an adherence to a strict legal interpretation of the independence of the two corporations to a virtual absorption of the lessor company in the lessee.

In the latter case, the lease usually runs in perpetuity or for a length of time practically equivalent. The stock of the lessor is practically all owned by the lessee, the lessee has often issued securities of its own to cover the absorbed property, and has pledged the stock of the lessor company for the new issue, or is carrying it on its books merely as a record of title. Frequently the only possession remaining to the lessor corporation is its franchise. The lessor company becomes, in other words, an inactive corporation, existing neither for the purpose of conducting a railroad business nor for the purpose of distributing

income to its stockholders. It is such cases which can properly be classified as forms of control, tho even here the lessor is still in law an independent corporation. A good illustration of a lease that is merely formal in character is found in the Dayton & Western Railroad Company, which in 1865 leased all of its property of every kind to the Little Miami and Columbus & Xenia Railroad companies for the term of ninety-nine years, renewable forever, subject to a mortgage securing the payment of \$738,000 of bonds due in 1905. The lessee guaranteed payment of principal and interest on the bonds and all taxes and assessments, the rental payment being the interest on the bonds until maturity, and thereafter 5 per cent. per annum. But, after the payment of the bonds, the lessee might at any time demand a conveyance of the railroad in fee simple without further consideration. The Columbus & Xenia Railroad was subsequently leased to the Little Miami, and, by a later lease, the little Miami was conveyed to the Pittsburg, Cincinnati, Chicago & St. Louis Railway Company. The bonds of the Dayton & Western have now been paid, and the corporation exists merely for the purpose of formally conveying title when that act is demanded.

But the clearest form of control is that established through the possession of securities. Sometimes the possession of bonds is sufficient where bonds have the controlling voting power, or where, interest having been defaulted, the holders of bonds possess right of foreclosure. Occasionally a corporation holds a majority of voting trust certificates representing stock deposited with trustees. While not in direct control of the corporation whose certificates are held, the owning company, nevertheless, names the trustees, and comes into possession of the stock when the trust is dissolved. An illustration of this relationship is the ownership by the Seaboard Company of a majority

of the voting trust certificates of the Seaboard Air Line Railway.

But by far the greater number of railroad corporations are controlled through the ownership of stock, obtained sometimes by exchange of securities, either stock or bonds, for the stock acquired; sometimes by the sale of bonds on the market and the purchase of stock with the proceeds; and sometimes, altho not commonly when large purchases are involved, by direct appropriation of cash from the treasury. It is by the acquisition of voting securities that the large systems have in the main been built up. This does not, of course, mean that the head corporation, which gives its name to the system, necessarily itself owns the securities of all the corporations which it controls. In practically all the large systems the policy of indirect control is followed to a greater or less extent; that is, corporations subsidiary to the head of the system in their turn control other corporations, so that a hierarchy of corporate interests is created, often of a most intricate nature. It is this fact that made so difficult the work of compilation in the Interstate Commerce report already referred to, and it is the presentation of this relationship in tabular form that constitutes perhaps the most valuable feature of the report. To take a familiar instance, the New York Central & Hudson River Railroad Company controls the Lake Shore & Michigan Southern through ownership of a little over 90 per cent. of its stock. The latter in turn controls the Cleveland, Cincinnati, Chicago & St. Louis through ownership of 53 per cent. of its stock, and the New York, Chicago & St. Louis through ownership of a little over 50 per cent. of its stock. These roads in turn control others, so that the influence of New York Central management runs down the line until it reaches the most insignificant branches. Thus has this great system been built up until it aggre-



gates nearly 12,000 miles and represents a total outstanding capitalization, both stock and bonds, of over \$1,300,000,000.

In many cases a railroad corporation, in addition to its control through title to a majority of the voting securities, is also the lessee of the controlled corporation. Usually the lease contract comes first in point of time, and then, later, stock is acquired sufficient to insure voting control, as the advantages of a closer intercorporate relationship become clear. But sometimes the lease contract is subsequent to the establishment of control through stock ownership. The execution of a lease under these circumstances, or the continuance of an early lease when stock control would seem to render such contract unnecessary, finds its explanation in the fact that a railroad corporation holding a bare majority of the stock of another railroad is enabled, through the exercise of its voting control, to arrange an advantageous contract with its subsidiary corporation which remains fixed during the life of the lease, and is thus able to free itself from the importunities of a possibly dissatisfied minority of the lessor corporation for a considerable length of time.

Thus far discussion has been confined to control exercised by a single corporation. But there are frequent cases of joint control, the participating corporations sometimes numbering as high as twelve. The fact of joint control is difficult to establish, because the line of distinction is not clear between the mere contemporaneous investment of several railroads in the same corporate stock and the acquirement of securities under an agreement for joint control. Joint control necessitates, of course, an agreement between the parties in interest, but these agreements are frequently so informal that they escape detection. Moreover, railroads have been very

reluctant to admit the existence of such agreements, possibly because they fear that the revelation of joint contracts of any character may render them liable to prosecution under the Anti-trust Act. In the Intercompany Relationship investigation it was found necessary to adopt the wholly reasonable basis of interpretation that when railroad corporations invested simultaneously in the securities of a corporation in which they were all obviously interested, such as a terminal or switching company, and particularly when the amount of the investment was practically identical for each of the investing corporations, the corporation whose securities were acquired was to be regarded as jointly controlled.

Joint control may be created by lease, as in the case of the joint lease of the Georgia Railroad by the Atlantic Coast Line and the Louisville & Nashville, but usually such control is based upon stock ownership. An illustration of this is the control of the Chicago, Indianapolis & Louisville by the Southern and the Louisville & Nashville through joint ownership of 88 per cent. of the stock. Two interesting cases in which the Harriman interests were involved are those of the North-western Pacific and the Chicago & Alton. The first-named corporation was organized to consolidate all the competing lines of the Santa Fé and the Southern Pacific systems north of San Francisco Bay, and the board of directors is divided between these two controlling systems. In the case of the Alton, the Union Pacific and the Rock Island deposited a controlling interest with the Central Trust Company of New York, under an agreement by which the control of the board of directors was to be transferred in successive years from one to the other.<sup>1</sup>

Agreements for joint control do not always include all

<sup>1</sup> This agreement has been annulled, and control of the Alton passed in August, 1907, to the Toledo, St. Louis & Western Railroad Company.

of the large corporate stockholders. Note, for example, the case of the Southwestern Construction Company, the holding company for the stock of the Cincinnati, New Orleans & Texas Pacific Railway. About 80 per cent. of the stock of the former corporation is controlled by the Southern Railway and the Cincinnati, Hamilton & Dayton through direct ownership and through the holdings of their subsidiary corporations. Nearly \$450,000 of stock, or over 20 per cent., is owned by the Alabama, New Orleans, Texas & Pacific Junction Railways Company, Limited. Yet this latter corporation has no voice in the management of the Southwestern Construction Company. The Southern Railway elects four directors, the Cincinnati, Hamilton & Dayton four, and these eight choose the ninth and remaining member.

In agreements for joint control a corporation's influence in the affairs of the controlled company is not always proportionate to its investment. For example, the stock of the Des Moines Union Railway Company is owned five-eighths by F. M. Hubbell Son & Co., two-eighths by the Chicago, Milwaukee & St. Paul Railway Company, and one-eighth by the Wabash Railroad Company. Yet a director cannot be elected, the articles of incorporation amended, or the capital stock increased except by a vote of more than seven-eighths of the stock, which means unanimous consent.

In rare cases joint control is shared by a corporation and an individual, as, for example, in the case of the San Pedro, Los Angeles & Salt Lake Railroad Company. This line, as projected, threatened the traffic of the Southern Pacific. By legal proceedings Mr. Harriman prevented the construction of portions of this road until an agreement had been effected between himself and the builder, Mr. W. A. Clark, as a result of which the stock of the railroad was deposited with the Farmers' Loan and

Trust Company as trustee and was to be owned half and half by the Oregon Short Line and Mr. Clark and his associates.<sup>1</sup>

Most of the cases where control is shared by two or more railroad corporations have an obvious explanation and are justified on economic grounds. They arise where terminal tracks, a union station, or a short connecting line, is necessary to the operation of a number of railroad systems. Frequently the expense of construction and operation of such joint property represents the only investment that the railroads make, and stock, if issued at all, is distributed to each contributor merely as a matter of form. But instances such as the San Pedro case are less defensible, and contain within themselves more than a possibility of effecting that "restraint of trade" which the courts have so frequently denounced.

Virtual control of a railroad corporation may be maintained even when less than a majority of stock is owned. Thus in some cases the stock necessary to convert a minority into a majority holding is in the possession of individuals or groups of individuals whose interests are identical with those of the holding corporation. Well-known instances of this kind include the control by the Chicago & Northwestern Railway of the Chicago, St. Paul, Minneapolis & Omaha, in which a holding of \$1,500,000 of stock by F. W. Vanderbilt is necessary to make a majority. The ownership of 45½ per cent. of the stock of the Southern Pacific Company by the Oregon Short Line Railroad Company—a part of the Union Pacific system—doubtless belongs in the same category, altho the individual financial interests which fill the gap are not revealed. A concentrated minority holding is doubtless in many cases fully as effective as an actual majority would be, because of

<sup>1</sup> The agreement also contains provisions relative to division of traffic and territory with which this discussion is not concerned.

the scattered distribution of the majority ownership in small lots. Yet the occasional market raids during the last decade on the stock of prominent railroad corporations have led financial interests to question the security of a minority holding, however large and concentrated, and to endeavor to ally with the corporate holding a sufficient amount of personal holdings to insure an actual voting majority. The revised annual report form of the Interstate Commerce Commission, upon which railroads are making their returns for the year ending June 30, 1908, calls for the ten largest stockholders of each corporation. This information gathered currently will enable the public to keep accurately in touch with the investments of large financial groups, and will make possible in the future a clearer understanding of these alliances of individual and corporate interests. This method of corporate control through the aid of individuals undoubtedly adds an element of difficulty to any attempt at regulation or judicial interference.<sup>1</sup>

This treatment of intercorporate control has had to do with the securities of *active* railroad corporations; that is, with the securities of those corporations which either operate railroad property or, as owners of railroad property operated by other corporations, maintain an organization for the distribution of income to stockholders. But there is a very large number of railroad corporations, whose securities are found on the books of the controlling corporation, that perform neither function and that still exist in contemplation of law. In some cases such corporations still retain title to their property; in other

<sup>1</sup> Were this article not confined to railroad corporations, it would be interesting to discuss the significance of the control by railroads of steamship lines, such, for example, as the control of the Pacific Mail Steamship Company by the Southern Pacific and of the Old Dominion Steamship Company by the Chesapeake & Ohio, Southern Seaboard Air Line, Norfolk & Western, and Atlantic Coast Line.

cases they have transferred title to the controlling corporation, and retain merely their corporate right to be.<sup>1</sup> The property represented by such *inactive* corporations has in almost every case been absorbed into the operating system of the controlling corporation, and it would naturally be expected that the corporate existence of such inactives should be discontinued. To some extent this has taken place, and corporations have unified and simplified their organization by ending the life of their "inactives." Nevertheless, these moribund companies still exist in great numbers, doubtless because their charters give them certain privileges which counsel for the controlling roads regard as valuable possessions against a future emergency. The total outstanding securities of these inactive corporations on June 30, 1906, amounted to \$412,000,000 of funded debt and \$771,000,000 of stock. Of the funded debt \$120,000,000 was in the hands of the public. Some of it was doubtless of no value, but most of it had been assumed as a direct obligation of the absorbing road. Only \$5,500,000 of the total amount of stock was still outstanding, and this doubtless has no value at all and could be located with difficulty. The absorption of such inactive corporations has been complete.

Thus far the discussion has been concerned with the question of intercorporate control. But there exists to an enormous extent corporate ownership of railroad securities, which, altho falling short of control, secures for the holding corporation a potent influence in the affairs of the railroad whose securities are owned. It would be tedious merely to enumerate here the list of important alliances of this character. Furthermore, official information is available only as late as the year ending June 30,

<sup>1</sup> In still other cases corporate existence has ceased, but the stock of the dead company is carried on the books of the successor as a matter of record.

1907, and a statement of these facts would not picture the present situation with entire accuracy. The motives of financial interests change as conditions change; legislation makes certain holdings undesirable, as illustrated, for example, in the sale of stock of "coal roads" since the passage of the Hepburn Act with its "commodity clause"; financial difficulties sometimes compel a railroad to convert its influence in other roads into cash, as in the recent reported sale by the Erie of its Lehigh Valley stock. Old alliances are dissolved and new ones formed with bewildering frequency. As illustrations of these minority holdings acquired for the purpose of influencing, if not controlling, the policy of other roads, may be mentioned the holdings of the Pennsylvania Railroad system in the Baltimore & Ohio, the Norfolk & Western, and the New York, New Haven & Hartford; the holdings of the New York Central system in the Chesapeake & Ohio and the New York, New Haven & Hartford; the holdings of the Baltimore & Ohio, the Chesapeake & Ohio, the Erie, the Lake Shore, and the "Panhandle" in the Hocking Valley; the holdings of the Lackawanna, the Erie, the Lake Shore, the Reading, and the Central of New Jersey in the Lehigh Valley; of the Chicago & Northwestern in the Union Pacific; and of the Missouri Pacific in the Denver & Rio Grande, the Texas & Pacific, and the Wabash. A most interesting instance which approaches a condition of joint control is the influence of the Pennsylvania and the New York Central systems in the Reading Company through the holding by the Baltimore & Ohio and the Lake Shore of over \$30,000,000 each in Reading stock, an aggregate of over 43 per cent.

During the interval between the annual reports to the Interstate Commerce Commission for 1906 and 1907 the Pennsylvania system disposed of all its Chesapeake & Ohio stock, amounting to over \$15,000,000, and the New

York Central system sold \$4,500,000 of its holdings in the same road. Who the purchasers were does not appear. A more interesting case is the reduction in the Pennsylvania holdings of Baltimore & Ohio stock from \$73,000,000 to \$42,500,000. At the same time there appears among the new holdings of the Oregon Short Line for the year 1907 about \$40,000,000 of Baltimore & Ohio stock, and among the new holdings of the Pennsylvania Company \$34,000,000 of Oregon Short Line bonds. An inference that would be fairly accurate might be drawn concerning this particular ramification of Harriman finance.

As a rule, these minority holdings are in the securities of railroads that have traffic relations with the holding corporation, and that lie in the same general traffic territory,—where, in other words, influence in management will promote harmony of operation, if not community of interest. But occasionally, as already noted, a railroad corporation purchases widely in the securities of other railroads, possibly to some extent for pure investment purposes, but more probably with far-reaching plans for future coalitions. The most striking instance of this character is seen in the case of the Oregon Short Line Railroad Company, which is the principal “holding company” for Mr. Harriman’s system of railroad lines, and which he has made the depository for a large proportion of his purchases during the conduct of his pyrotechnic finance. The important holdings of the Oregon Short Line in the securities of other railroad corporations on June 30, 1907, were as follows:—

Atchison, Topeka & Santa Fé, preferred . . . . .	\$10,000,000
Baltimore & Ohio, common . . . . .	32,334,200
Baltimore & Ohio, preferred . . . . .	7,206,000
Chicago, Milwaukee & St. Paul, common . . . . .	3,690,000
Chicago, Milwaukee & St. Paul, common, 25 per cent. paid,	922,500
Chicago, Milwaukee & St. Paul, preferred, 25 per cent. paid,	1,845,000
Chicago & Northwestern, common . . . . .	3,215,000



Great Northern, preferred . . . . .	\$9,036,400
Great Northern, preferred, 50 per cent. paid . . . . .	3,614,560
New York Central & Hudson River . . . . .	14,285,700
Northern Pacific, common . . . . .	4,152,800
Northern Pacific, common, 12½ per cent. paid . . . . .	2,491,600
Northern Securities, stubs . . . . .	724,900
San Pedro, Los Angeles & Salt Lake . . . . .	12,500,000
San Pedro, Los Angeles & Salt Lake, first mortgage bonds, . . . . .	20,000,000
Southern Pacific, common . . . . .	90,000,000
Southern Pacific, preferred . . . . .	18,000,000
Southern Pacific, preferred, 25 per cent. paid . . . . .	16,200,000

In addition, it may be noted that the Union Pacific Railroad Company owns \$10,343,100 of the stock of the Chicago & Alton, also \$18,623,100 of Illinois Central stock directly, and \$8,000,000 through control of the Railroad Securities Company.

That this policy of Mr. Harriman's has been deliberately entered upon is shown by his testimony in a hearing before the Commission, in which he said, "If I thought we could realize something more than we have got from these investments, I would go on and buy some more things. . . . If you will let us, I will go and take the Santa Fé tomorrow."<sup>1</sup> That he is still pursuing the same policy is shown in his recent purchase of the stock of the Central of Georgia which connects with the Illinois Central at Birmingham, Alabama, and in the financial aid which he is reported to have given this year to both the Erie and the Wheeling & Lake Erie Railroads, which have presumably given him an influence in their councils.

That the intercorporate holdings of railroad securities reach an enormous aggregate is shown by the Interstate Commerce Commission's investigation which presents the situation on June 30, 1906. This investigation shows that of the total outstanding stock of railroad corporations

<sup>1</sup> In the Matter of Consolidations and Combinations of Carriers, Relations between such Carriers, and Community of Interests therein, their Rates, Facilities, and Practises. Interstate Commerce Commission, 1907.

on that date, amounting to nearly \$9,000,000,000, over \$4,000,000,000, or 46 per cent., was held by railroad corporations; and that, out of \$9,000,000,000 of funded debt, \$1,440,000,000, or a little over 15 per cent., was held by railroads.

This striking contrast between the percentage of funded debt and of stock held by railroads leads to the inevitable conclusion that railroads in their purchase of railroad securities are not primarily seeking investments, but that the main consideration is the strategic advantage to be derived from the possession of voting stock. The enormous intercorporate holdings of railroad securities also warn the student of railroad finance that a considerable duplication of securities must be eliminated before the net amount in the hands of the public upon which railroads are entitled to earn can be determined. This net amount as shown in the 1906 investigation was \$7,840,000,000 of funded debt and \$4,740,000,000 of stock, or \$36,173 per mile of funded debt and \$21,877 of stock. It is probable that this net amount will be further reduced by a later and still more exhaustive investigation.

We turn finally to a consideration of the most interesting phase of the intercorporate relationship problem,—the position and character of the “holding company.” This “holding” function is not confined to corporations expressly organized for the purpose. Almost every large operating railroad company acts to some extent at some time as a “holding company” for financial interests that direct the system to which it belongs. Occasionally this is true to a very considerable degree, as in the case of the Oregon Short Line already described. Trust companies also have in recent years often acted in this capacity. For example, the stock of a large number of railroad corporations comprising the Reading system was in 1906 held

by the Central Trust Company of New York as trustee for the Reading Company. Sometimes this holding function is performed by an individual who, in his capacity as president or other officer of a railroad company, holds for that company the stock of another railroad corporation. Whatever the motive may be for this general policy, it increases the government's difficulty in securing full information as to intercorporate alliances. The corporation whose stock is held may reasonably insist that its information concerning its stockholders does not extend beyond its stock books, and moreover it is at least questionable whether the Commission has jurisdiction over trust companies or over individual trustees who appear to be holding stock in their individual capacity. The advantage of such a policy to a railroad that desires to conceal its control of another railroad is obvious. Such concealment may be promoted, however, with a view to deceiving business rivals and competitive financial interests rather than government authority. Hostility to government interference in matters of this kind is based much less on a fear of prosecution for violations of law than on the possible effect of publicity upon the strategic position of the corporation among its rivals.

But beyond this comparatively simple method of holding corporate securities there is the "holding company" chartered expressly for the purpose of performing this function and given by the law of the State, usually New Jersey, the power to purchase, hold, and sell securities and to issue its own obligations in return therefor. Such corporations have assumed many different forms and have been assigned the performance of varied services, but in principle they do not differ. Their variations depend upon their differences in location in the railroad system of which they are a part and the diversity in the character of the securities held by them.

Thus there are the holding companies that are at the head of railroad systems and that bind together the different operating railroad lines under the control of a single financial interest.<sup>1</sup> Then there are the intermediate holding companies that hold securities in the interest of the railroad corporation or corporations by which they are controlled. These companies in turn may be either purely railroad holding companies organized specifically for the purpose of holding the stock of one or more railroad corporations, or they may be the safety deposit for a mass of miscellaneous securities that the railroad does not desire to carry on its own books.

A few examples will make the point of this discussion clear. The Michigan Securities Company with a capital stock of only \$20,000, all of which is owned by the Cincinnati, Hamilton & Dayton, is the agency through which the latter corporation held on June 30, 1907, among other securities, \$11,000,000 of the capital stock of the Pere Marquette and \$750,000 of the stock of the Southwestern Construction Company. The Illinois Central has within its system two holding companies of this character, of which it owns the entire capital stock. One, the Mississippi Valley Company, has a capital stock of \$300,000 and controls four railroad corporations, including the Yazoo & Mississippi Valley with over 1,200 miles of line, and a capitalization of \$6,000,000 of stock and \$53,000,000 of funded debt. The other, the Mississippi Valley Corporation, has a capital stock of \$5,000 and a funded debt of nearly \$8,000,000, and controls solely and jointly ten terminal, bridge, depot, elevator, and small railroad companies, with an aggregate capitalization of \$17,000,000, besides owning securities in a number of other companies. The Union Pacific owns 95 per cent. of the stock of the

<sup>1</sup> Such holding companies should not be confused with corporations like the Southern Pacific Company and the Pennsylvania Company, which own no mileage, but which operate railroad systems.

Railroad Securities Company. The latter has purchased \$8,000,000 of Illinois Central stock, and has pledged this as collateral for the issue of an equivalent amount of bonds. Its authorized issue of bonds is \$20,000,000, but the unissued \$12,000,000 can only be put out against the deposit of an equal amount of Illinois Central stock in addition to that already in the hands of the trustee. The Southwestern Construction Company, which owns 68 per cent. of the capital stock of the Cincinnati, New Orleans & Texas Pacific, is similar in character to those already described, except that it is controlled jointly by two railroad corporations, the Southern and the Cincinnati, Hamilton & Dayton.

The Pennsylvania Company, altho not identical in character with the corporations already mentioned, may roughly be classified with this group. Its capital stock of \$60,000,000 is all owned by the Pennsylvania Railroad Company. On June 30, 1907, it owned no mileage, but operated 1,413 miles of road west of Pittsburg. It owned over \$138,000,000 of railroad stock and \$95,000,000 of bonds. A large proportion of its holdings were pledged for the issue of collateral trust bonds, which form a large majority of its funded debt. That it has been used by the Pennsylvania Railroad Company as a holding company has been shown earlier in discussing the sale of Baltimore & Ohio stock. That it is also used as a medium for the issue of new obligations may be learned from the statement of officers of the Pennsylvania Railroad Company, who in reply to inquiries have said:—

In regard to the issues of the Pennsylvania Company obligations, the Pennsylvania Company is simply a bureau of the Pennsylvania Railroad Company, which owns every share of its capital stock; and for the same reason that the Pennsylvania Railroad Company takes charge of the issue of the car trust certificates to cover additional equipment furnished to all its lines both East and West of

Pittsburg, it feels itself entirely at liberty when short term securities have to be issued to use the Pennsylvania Company for that purpose, or to use the Pennsylvania Railroad Company as it may prefer. . . .

. . . One of the objects in view when the Pennsylvania Company was organized was to enable it to do just the things for which the Pennsylvania Railroad Company is now using it; and in granting its charter the State gave it certain exceptional privileges which are not possessed by the Pennsylvania Railroad Company under its charter. It is, therefore, of special value to the Pennsylvania Railroad Company for this reason, and, as the reports of the two companies state these transactions very clearly, it is not thought that any obscurity or misapprehension can exist in reference thereto.<sup>1</sup>

Similar in character and purpose to the instances already noted are many of the so-called development, improvement, investment, and land companies. Nearly every railroad corporation of any size has organized and owns the stock of companies whose purpose is to purchase and sell real estate and other miscellaneous properties. It was formerly the practise for this function to be performed by an individual, but the complications and delays that arose in the transfer of title upon the death of any such trustee led to the substitution of corporations. In a considerable number of cases these companies have also been used as holding companies for securities of subsidiary railroads. For example, the Erie Land and Improvement Company, the entire capital stock of which is owned by the Erie Railroad, owns the entire capital stock of the Southern Tier Development Company, which in turn owns stock in one steam railroad, two electric railways, and a lake line. The Santa Fé Land Improvement Company, whose stock is all in the possession of the Atchison, Topeka & Santa Fé Railway Company, owns \$309,900 of the capital stock of the California-Nevada

<sup>1</sup> Snyder, *American Railways as Investments*, p. 554.

Railroad Company. But the most important illustration of this form of holding company is the Northwestern Improvement Company, owned entire by the Northern Pacific Railway. This company owns securities of steam railroads, terminal, navigation, irrigation, express, land, and mining companies amounting to over \$27,500,000.

A most interesting example of the extent to which this holding company principle may be carried is that of the Lake Superior Company, Limited, an agency of the Great Northern Railway Company. No official information is available, but it appears from the discussion in financial journals that this company is a limited copartnership, organized in 1899 under the laws of Michigan with a nominal capital of \$100,000. It has three stockholders, James J. Hill, Louis W. Hill, and Robert I. Farrington, all officers of the Great Northern Railway Company. By a deed of trust, the Great Northern transferred to the Lake Superior Company, Limited, securities to a total par value of over \$8,000,000, including stocks and bonds of railroad, terminal, express, elevator, land, water-power, bridge, and mining companies. This partnership has since been used as a means of acquiring real estate, lumber, and ore lands, the earnings of its investments being largely reinvested instead of being distributed as dividends.<sup>1</sup> Of all these interesting transactions not a trace appears in the annual report of the Great Northern Railway Company to the Interstate Commerce Commission, nor even in its report to its own stockholders, except for the announcement in the report for 1900 of the organization of the company.

As a rule, the relation between the holding company and the railroad is a simple one and can readily be traced and understood, but occasionally the entanglements

<sup>1</sup> The ore lands acquired have since been transferred to trustees to be held and managed by them for the benefit of the holders of Great Northern ore certificates.

of the intercorporate relationship are so extensive that legal counsel and the courts have had difficulty in following their ramifications. Nothing short of a drastic reorganization would in many cases be sufficient to disentangle the maze and reduce the relationship to one of simplicity.

The Intercorporate Relationship Report of the Interstate Commerce Commission contains a diagram of the relations of railroads comprising the Queen & Crescent route, which well illustrates the point. The Southwestern Construction Company, itself a holding company for the Cincinnati, New Orleans & Texas Pacific, is owned by the Southern, by the Cincinnati, Hamilton & Dayton through the Michigan Securities Company, a holding company, and by the Alabama, New Orleans, Texas & Pacific Junction Railways Company, Limited, another holding company, the latter being largely controlled by railroads subsidiary to those already mentioned, through the possession of a one-fourth undivided interest in its stock.

Another instance is that of the New York, New Haven & Hartford, which was merged in 1907 with the Consolidated Railway Company. The Consolidated Railway Company represented in the first place the consolidation of a large number of electric railway companies within the State of Connecticut. In addition, it had vested in it the control of the New England Investment and Security Company, a voluntary association organized to hold the stocks of the various traction properties owned by the New Haven within the State of Massachusetts.<sup>1</sup> Again, the Consolidated Railway Company acquired control of the Rhode Island Securities Company, which was the sole owner of the stock of the Rhode Island Company, the

<sup>1</sup> This device was in May, 1908, declared unlawful by the Supreme Court of Massachusetts.



latter controlling through lease electric railway, electric light, and gas companies in Providence and vicinity. Finally, the Providence Securities Company was organized for the purpose of financing the acquisition of the securities of the Rhode Island Securities Company, and the stock of the Providence Company is all owned by the New Haven. Even without these holding companies heaped one upon another, the New Haven system would have been sufficiently complicated, for it is made up of merged lines whose obligations have been assumed; of roads controlled through stock ownership, some operated independently, some by New Haven management; of leased roads; and of roads whose lease contract has been assumed in connection with the lease or control of its lessee. But the extensive venture of this corporation into electric railway ownership and operation has been accompanied by a further tangle of intercorporate alliances that is difficult to justify. In many cases such a confused situation as this has doubtless grown up gradually, and the difficulties, legal and otherwise, of getting rid of it are greater than those of maintaining the existing status. But, notwithstanding all this, it must be evident to any one who gives the matter close study that complications such as these are frequently looked upon with favor because they give opportunity for inflated stock issues and market manipulation, for an intermingling of interests that will confuse the public and hamper regulating bodies, both State and federal, and for a situation that will furnish a means of escape to important transportation agencies from the jurisdiction of State and interstate commissions.

The holding company frequently performs an economic service when it brings small scattered corporations together as a preliminary step to consolidation, or when it is used as a convenient device for joint control by two

or more railroad corporations of some railroad property in which they have a legitimate joint interest, provided of course that the financial transactions of such a holding company are made as public as those of the railroad corporations that own it. But, when it is a scheme deliberately invented for the purpose of avoiding publicity and inspection and as a means of carrying on business not permitted by its charter, its continuance becomes a public menace. In such cases the books of the holding company are frequently kept by separate officers independent of the railroad accounting officials, and the railroad is able to report that it is not officially informed of the financial transactions of the holding company whose stock it owns. Thus the Great Northern Railway Company reports to the Interstate Commerce Commission that its interest in the Duluth, Superior & Western Terminal Company is merely that of a lessee of a portion of its property, altho it appears that the Lake Superior Company, Limited, owns \$1,999,500 of its stock out of a total outstanding of \$2,000,000. Thus is the Yazoo & Mississippi Valley able to state under oath to the Commission that it is not controlled by any other railroad company, altho it is controlled by the Mississippi Valley Company, whose entire capital stock is owned by the Illinois Central.

But the holding companies that are of the greatest interest to the public are those at the head of great railroad systems. Three illustrations will suffice to describe this class, the Atlantic Coast Line Company, the Reading Company, and the Rock Island Company. The unique feature of the Atlantic Coast Line Company is its small capitalization in comparison with the securities it holds. This company was organized in 1889 to bring under unified control the group of railways later consolidated into the Atlantic Coast Line Railroad Company. It had

a capital stock of \$10,000,000, which in 1897 was reduced to \$5,000,000 by the issue of certificates of indebtedness in place of the stock retired. The next year the stock was restored to its original amount of \$10,000,000 by a stock dividend of 100 per cent., representing accumulated surplus. On June 30, 1907, this company had outstanding \$12,600,000 of stock and \$13,000,000 of certificates of indebtedness. It owned \$25,266,300 out of \$50,134,200, or a little over 50 per cent. of the stock of the Atlantic Coast Line Railroad Company and \$11,500,000 of its funded debt, the latter being pledged for a portion of its own certificates of indebtedness. When it is recalled that the Atlantic Coast Line Railroad Company in turn holds 51 per cent. of the stock of the Louisville & Nashville Railroad Company, and that this latter corporation owns jointly with the Southern Railway 88 per cent. of the stock of the Chicago, Indianapolis & Louisville, and is a joint lessee with the Atlantic Coast Line Railroad Company of the Georgia Railroad, it will be seen that less than \$6,500,000 of Atlantic Coast Line Company stock, constituting a majority, controls solely and jointly a railroad system 11,000 miles in extent with a total capitalization of over \$725,000,000. No similar instance can be discovered of such wide-reaching control on the basis of so small a capital.

The peculiarity of the Reading Company is that it unites under one management railroad and mining properties. This company has a capital stock of \$140,000,000 and funded debt of nearly \$105,000,000. It owns all the stock and a portion of the funded debt of the Philadelphia & Reading Railway Company, all the stock of the Philadelphia & Reading Coal and Iron Company, and 53 per cent. of the stock of the Central Railroad of New Jersey. In addition it owns about \$20,000,000 of bonds and \$35,000,000 of stock in sundry other companies,

including steam and electric railways, dock, terminal, navigation, ferry, bridge, mining, telegraph, real estate, and hotel companies, and stock exchanges. In this list is included the stock of nearly all the roads comprising the Philadelphia & Reading Railway system, these roads being operated by the latter under lease. Even the railroad and marine equipment used in operation is leased from the Reading Company.

The Rock Island was chartered in 1902, with the State of New Jersey as its gracious god-father. It has \$139,000,000 of capital stock and no debt. This company owns the entire stock issue of the Chicago, Rock Island & Pacific Railroad Company, which was chartered in Iowa as an operating railroad, but which neither owns nor operates mileage and is simply a holding device for the convenient use of Rock Island financiers. This latter corporation in turn owns 93 per cent. of the stock of the Chicago, Rock Island & Pacific Railway Company—the principal operating company of the Rock Island system—and 58 per cent. of the stock of the St. Louis & San Francisco Railroad Company. The Chicago, Rock Island & Pacific Railway owns half the stock of the Alton, and the St. Louis & San Francisco controls the Chicago & Eastern Illinois, which in turn controls the Evansville & Terre Haute. Two more facts are necessary to make clear the underlying purpose of this gigantic structure. First, holders of the preferred stock of the Rock Island Company have the right, to the exclusion of holders of the common stock, to elect a majority of the board of directors, such right to be surrendered only with the consent of two-thirds of the preferred stockholders. And, second, the amount of the preferred stock cannot be increased except upon the affirmative vote of two-thirds of the entire preferred and two-thirds of the entire common stock. In other words, holders of a majority of the preferred stock,

or one share over \$27,000,000, have permanently intrenched themselves in control of a railroad system of 15,000 miles with total outstanding capitalization, stock and funded debt, of \$1,500,000,000, and they have issued \$380,000,000 of holding company securities in the prosecution of their plans.<sup>1</sup>

That such an inflation of securities as is found in the case of the Rock Island and other holding companies is a public danger cannot be questioned, but that it results in a demand for higher rates in order to pay dividends on such securities is a charge that can hardly be sustained. The pure holding companies derive their income solely from the securities they hold, and demand no direct contribution from the public. Furthermore, so far as the actual amount of railroad securities outstanding in the hands of the public is concerned, the total is not as a rule greatly increased by the presence of the holding company, for the par value of holding company capitalization is in most cases less than the par value of the securities which it holds and upon which its own capital is supported.<sup>2</sup> To be sure, in the Rock Island Company case the total amount of securities in the hands of the public has been increased beyond the amount that would have been in existence, had the railroad corporations been left undisturbed. But this is an exceptional instance, and there are here two holding companies in action instead of one. Justification for public alarm over inflated capitalization, so far as such increase in securities affects rates, should arise not from the attitude of the holding company,

<sup>1</sup> A striking example of holding company finance in the municipal field is that of the Interborough Metropolitan Company, which, through ownership of the Interborough Rapid Transit Company, the Metropolitan Securities Company, and the Metropolitan Street Railway Company, is in control of the entire local transportation situation in New York City.

<sup>2</sup> This discussion is limited to railroad-holding companies. The statements made concerning the apparent lack of inflation of securities would be modified considerably, were holding companies in general under consideration.

but rather from that of the operating railroad corporation, which is itself the holder of the securities of another railroad. Such a company frequently contends for rates adequate to pay a "reasonable return" upon its entire capitalization when a portion of that capital was issued to cover the acquisition of securities of other roads. From the public can fairly come only the earnings necessary to support capital that covers the actual property of the corporation employed in transportation; support for the remainder of its capital must obviously come from the securities it owns. It was with the purpose of determining the amount of capital that represents operating railway property and of eliminating such duplication of securities that the Commission's Intercorporate Relationship investigation was undertaken. It was found that out of a total gross outstanding capitalization, funded debt and stock, of over \$18,000,000,000, railroad corporations held \$5,500,000,000, leaving \$12,500,000,000 in the hands of the public. This figure, altho subject to correction in later investigations, is the one that should be accepted as measuring approximately the actual value of railroad property.

That the holding company does influence rates to some extent is true, but in a more indirect manner. So far at least as the large holding company at the head of a system is concerned, its profitable life depends upon the income that it derives from the securities in its treasury. It is, therefore, of vital consequence to the financial interests in command that the railroads controlled shall declare a continuous dividend. This may necessitate the maintenance or even an increase of rates that seems unwarranted from the shipper's standpoint. However, the insistence upon dividend payments is more likely to affect the road's physical condition by preventing adequate charges to maintenance and depreciation, and in this

respect it menaces the investor quite as much as it does the shipping public.

Public opposition to the holding company has two explanations. In the first place, the device makes possible the concentration of interests of large public importance in a few hands. This seems to be the principal reason for its creation, at least so far as the holding company at the head of a system is concerned. It has the same advantage that a voting trust agreement possesses—but in permanent form—of perpetuating the control of a financial group whose holdings might otherwise become scattered. It is evident that, if the majority of the stock of a railroad company is owned by a holding company which votes it in a block, then a majority of the holding company's stock, which on a basis of par for par is only 26 per cent. of the railroad's capital, is sufficient to control the situation. The Rock Island Company is a striking case in point. The ill-fated Northern Securities Company was not different in principle, but it had the misfortune to hold the securities of parallel and competing roads. If the financial group in control has primarily at heart the transportation interests of its properties, such an organization need not injure the public. But the danger to both public and investor in railroad securities lies in the fact that such groups of financiers are too frequently interested in speculative finance rather than in railroading. There are present in such a situation conditions that amply justify public alarm.

The second cause for opposition to the holding company lies in the fact that it is not apparently subject to the regulation of the Interstate Commerce Commission. At least, it has not recognized such jurisdiction, and the question has not as yet been submitted to judicial determination. This makes it possible for a railroad corporation or a group of financial interests to refuse all informa-

tion concerning the holding company which it controls, and under cover of such immunity from public inspection to carry out policies that might otherwise be difficult or impossible. A railroad may, through the medium of a holding company, conceal its control of another railroad corporation. It may by the same means engage indirectly in businesses, such as mining, that are forbidden by its own charter. It may evade specific provisions of statutes or administrative orders of a regulating body. For example, the Reading Company, which owns both the Philadelphia & Reading Coal and Iron Company and the Philadelphia & Reading Railway, denies the jurisdiction of the Interstate Commerce Commission, and does not consider itself subject to the provision of the Hepburn Act which forbids railroads to transport, except for their own use, products which they own or which they have manufactured, mined, or produced.<sup>1</sup> Again, an accounting order of the Commission requires railroads to charge against operating expenses an amount adequate to cover depreciation of equipment. If the holding company owns the equipment and leases it to the railroad with no provision in the lease that such equipment shall be kept unimpaired, and, if the holding company is not subject to the jurisdiction of the Commission, the administrative order is nullified.

In these campaign days, when specifics are daily offered for all forms of economic disease, it is a wise conservatism that refrains from the proposal of too sure a remedy. But this study of the relations of railroad corporations to one another would suggest three lines of approach toward the removal of such evils as the situation has brought upon us, and they will be stated without discussion in this conclud-

<sup>1</sup> The "commodity clause" has been declared unconstitutional by the United States Circuit Court of Appeals, but has not yet been passed upon by the Supreme Court.



ing paragraph. They carry with them legal and possibly constitutional difficulties, the discussion of which, however, is outside the purpose of this paper. One is a law which would bring this increasingly popular device—the holding company—clearly and unequivocally under government jurisdiction, and compel from it that same publicity of accounting to which the railroad corporations are subject. The second would require government approval for all new issues of capital, and would define broadly what constitutes a legitimate basis for capitalization. The third would confine railroad corporations strictly to the business of transportation. A step will have been taken in this direction if the commodity clause of the Hepburn Act is finally sustained by the courts. The next step will be the prohibition of the exercise by railroads of the holding company function, and a confining of their ownership of securities of other railroad corporations to such as is necessary in the conduct of a legitimate transportation business.

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